

A.I.D. MICROENTERPRISE STOCK-TAKING:

MALAWI

A.I.D. EVALUATION OCCASIONAL PAPER NO. 20

by

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FOREWORD

During 1988 and 1989, A.I.D. undertook a major stock-taking of its experience in microenterprise development. The stock-taking examined differing approaches and techniques that have been used in efforts to assist microenterprises, including alternative institutional delivery mechanisms. The study was designed to identify patterns of A.I.D. project interventions that generate success, with the goal of establishing which were the most successful programs, institutions, and delivery techniques. It required an examination of the different types of microenterprises and of the way their problems differ, and an analysis of A.I.D. project approaches, to see which work best under which conditions.

The stock-taking included a conceptual overview paper of published evaluations that identified many factors that are important to project success. It also developed a conceptual framework for analyzing the types of problems microentrepreneurs face.

The stock-taking included field assessments of A.I.D. microenterprise assistance projects in 10 countries. These assessments provided an excellent opportunity to examine in a systematic, consistent manner a large number of project approaches operating under a variety of economic conditions.

The final part of the stock-taking was a synthesis, which pulled together the findings of the conceptual overview paper and the field assessments to develop lessons learned and recommendations for microenterprise assistance programs.

Malawi was one of the 10 countries examined in the field assessments, and the assessment focused on the Malawi Union of Savings and Credit Cooperatives and the Development of Malawian Traders Trust. This assessment provides interesting insights on one approach to promoting microenterprise development. We think that those who are working on microenterprise programs in Washington and in the field will be able to draw on the findings of this report to help in the planning, implementation, and evaluation of other microenterprise programs.

Janet Ballantyne
Associate Assistant Administrator
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Agency for International Development
July 1989

PREFACE

This report was based on a field evaluation undertaken in Malawi in July and August 1988 of the Rural Enterprise and Agribusiness Development Institutions Project (READI). READI, begun in 1984, is A.I.D./Malawi's umbrella project to help strengthen intermediary institutions serving the small-enterprise sector in Malawi. Two of those institutions, the Malawian Union of Savings and Credit Cooperatives (MUSCCO) and the Development of Malawi Traders Trust (DEMATT) have programs targeted towards microenterprises, employing from one to ten employees. Both were included as part of A.I.D.'s worldwide stock-taking exercise of microenterprise activities. Readers may receive a copy of the READI Project Evaluation Report by contacting the ARIES Project Office at Robert R. Nathan Associates, Inc. in Washington, D.C.

The authors wish to thank the staff of MUSCCO, DEMATT and READI for their support and cooperation during the evaluation period. Their dedication and commitment to increasing incomes and employment opportunities in Malawi were an inspiration to our team.

SUMMARY

Malawi is a long, narrow, land-locked country in southern Africa with an area of 45,750 square miles, and a population estimated at 7.5 million. The economy is agriculture-based and the population growth rate is placing pressures on land.

Information about the enterprise sector in Malawi is limited. The Rural Enterprise and Agribusiness Development Institutions (READI) project estimates that there are approximately 182,000 small enterprises are operating in Malawi. In a nationwide survey of microenterprises in Malawi READI found that more than 96 percent of entrepreneurs sampled were sole owners of their businesses. The majority of businesses fell into three categories: trading (42 percent), service (26 percent), and manufacturing (30 percent).

A.I.D. has provided funds for institutions to assist microenterprise for several years. Since 1980, A.I.D. has provided financial resources for microenterprise technical assistance, credit, and training primarily through the Development of Malawi Traders Trust (DEMATT) and the Malawi Union of Savings and Credit Cooperatives (MUSCCO). This support has come through various contractual and funding mechanisms. At the end of 1986, the READI project became the mechanism to continue financial support for DEMATT and MUSCCO.

In addition to A.I.D.'s initiatives, several other donors are actively providing support to Malawi's micro- and small enterprise sector. Donor coordination of small enterprise development is managed by the World Bank through a Donor Coordination Sub-Group on Small-scale Enterprises. Participants include representatives from the European Community, Germany, the Netherlands, various United Nations agencies, the World Bank, and A.I.D.

The two institutions which are the focus for this review are MUSCCO and DEMATT. Both organizations work with microenterprises: DEMATT provides business and technical advisory services; MUSCCO is a credit union movement dedicated to stimulating savings and facilitating group-based lending. Although most of MUSCCO's members are engaged in agriculture, some of their members do take loans to support the small shops or cottage industries they operate.

DEMATT was created in 1979 with a mandate "to offer advice, promote new business ideas, develop entrepreneurs, and facilitate access to credit." Prior to its participation in the READI project, DEMATT used a group training approach developed in Kenya in the mid-1970s. In 1986-1987, DEMATT provided business advisory and technical advisory services to 545 enterprises with a total of 1,254 employees. DEMATT classifies its clients into three types of enterprises: traders, producers, and service businesses. Based on sample survey data gathered in 1988, 37 percent of their clients are classified as traders, 54 percent as producers, and 9 percent as service enterprises. Five percent of DEMATT's clients were females engaged primarily in trading activities.

Financial self-sufficiency was an important objective for DEMATT in its early phases. DEMATT provides only technical assistance and training. In these circumstance, self financing through either side ventures or the imposition of client fees is unrealistic. Fees for services, although they may be useful for ensuring client commitment, cannot generate enough revenues to offset costs, given client willingness to pay. This should not exempt DEMATT from adopting a scale of fees based on the demand for services among their clients.

Client impact data is insufficient to measure impact. DEMATT has recently adopted a monitoring system which will yield useful information on client progress. But collection of any data is difficult because of clients' unwillingness to cooperate by supplying data.

MUSCCO is the apex body for the country's savings and credit cooperative societies. These cooperatives are in the words of MUSCCO's 1986 Annual Report: "the only financial institutions in the rural areas that provide both a place to save and a place to borrow."

MUSCCO began operations in 1980 with the objective of developing a sound and viable Credit Union movement throughout Malawi by improving the management skills and credit worthiness of credit societies and their members. MUSCCO field staff work to identify, develop, and eventually graduate groups of homogeneous savings and lending societies to financial self-sufficiency.

There is not enough data to determine how financially self-sufficient the member societies are. Generally speaking, the cost of operating a local credit society is low. Except for one or two paid bookkeepers, management expenses are negligible; for example, members of the board of directors which is responsible for setting policy and overseeing operations are not paid. It is thus possible for societies to be financially self-sustaining in terms of covering their operating costs from interest income, if their arrearages are controlled.

The most significant impact of MUSCCO has been to provide a savings and credit mechanism to rural poor in Malawi where none existed before. In many of the 79 villages that have credit societies, there are no other financial institutions or sources of credit other than the informal credit markets.

There is no data available to measure the income or employment impact of the loans to society members made by MUSCCO. Some of the borrowing finances household consumption, including school fees and funeral expenses. In addition, some of the borrowing finances productive investment including the purchase of fertilizer and other agricultural inputs according to informed observers. Gender disaggregated data on borrowers was not available.

Factors Influencing Project Performance and Impact

- (1) The projects lack management information systems and the administrative capacity to monitor their performance and measure their impact on beneficiaries.
- (2) The long term sustainability of these organizations is endangered by high administrative costs due to inefficiency, and an unwillingness to charge interest rates, or service fees high enough cover a significant portion of their operating costs.
- (3) The rigidity of formal sector financial markets means that DEMATT, MUSCCO, and other programs like them are the only ones providing credit and technical assistance to small enterprises in Malawi, and that graduating their clients to the formal sector is nearly impossible.
- (4) MUSCCO and individual credit union sustainability is adversely affected by the high level of arrearages.

Lessons Learned and Implications for Future Programs and Policy Directions

- (1) Credit unions are an effective way to develop a financial intermediary which provides saving and loan facilities to small clients.
- (2) It is costly and requires a significant period of time to develop national credit union networks with a relatively high degree of management sophistication.
- (3) Successful small-scale lending projects require a foundation of management skill development and ownership of capital resources, for providing credit to the rural informal sector markets.
- (4) Technical assistance focussed models like DEMATT's can charge at least nominal fees to clients to help cover costs and test the market value of services provided.
- (5) Microenterprise development projects need to establish baseline data from the start of the project assistance, and collect impact data on beneficiaries as the project is being implemented.
- (6) Projects supplying credit and technical assistance to microenterprises should develop a contractual mechanism with clients specifying the terms of participation, and offering mutually recognizable terms for termination of the contract.
- (7) The graduation to the formal sector of clients of promotional institutions such as DEMATT and MUSCCO is so unlikely it should not be a matter of practical concern .

PROJECT DATA SHEET

1. Country: Malawi
2. Project Titles: Malawian Union of Savings and Credit Cooperatives (MUSCCO) and Development of Malawi Traders Trust (DEMATT)
3. Project Number: 612-0214 (Refers to umbrella project -- Rural Enterprise and Agribusiness Development Institutions (READI) -- under which MUSCCO and DEMATT were funded)
4. Project Implementation:
 - a. Project authorization, 1984 - 1988
 - b. Final obligation, 1985
 - c. Final input delivery, March 1987, when funding for DEMATT was added to basic READI Grant Agreement
5. Project Completion-Final Disbursement: Funding of 2.0 million being considered for FY 89 to extend project to Dec 1989.
6. Project Fundings: Total READI Project -- \$5,800,000 August 1984 - Dec 1988.
 MUSCCO Component -- \$1,388,000 August 1984 - Dec 1988.
 DEMATT Component -- \$760,000 March 1987 - Dec 1988.
7. Mode of Implementation:
 - a. Grant Agreement between A.I.D./Malawi and the Government of Malawi
 - b. Grant Agreements between A.I.D. and Africare, A.I.D. and the World Council of Credit Unions for their participation in READI
8. Evaluations:
 - a. An Evaluation of the GOM/A.I.D. Rural Enterprise and Agribusiness Development Institutions (READI) Project, Robert R. Nathan Associates, Inc., August 1988.

GLOSSARY

A.I.D.	-	Agency for International Development
DEMATT	-	Development of Malawi Traders Trust
HRID	-	Human Resources and Institutional Development
MED	-	Malawian Enterprise Development Program
MEDI	-	Malawian Entrepreneurial Development Institute
MUSCCO	-	Malawian Union of Savings and Credit Cooperatives
PfP/I	-	Partnership for Productivity International
PVO	-	Private Voluntary Organization
READI	-	Rural Enterprise and Agribusiness Development Institutions
SEDOM	-	Small Enterprise Development Organization of Malawi
SHARE	-	Support for Health~ Agriculture and Rural Enterprises
UNDP	-	United Nations Development Programme
WOCCU/CUNA	-	World Council of Credit Unions/Credit Union National Association

1. COUNTRY SETTING

Malawi is a long, narrow, land-locked country in southern Africa bordered on the north and northeast by Tanzania, on the west by Zambia and on the south by Mozambique. Lake Malawi, the third largest freshwater lake in Africa, extends nearly the entire length of the country, demarcating most of the eastern border with Tanzania and Mozambique. Malawi's total area is 45,750 square miles, including 36,325 square miles of land (of which 36 percent is arable) and 9,425 square miles of water. Malawi's population in 1987 was an estimated 7.5 million, has an annual growth rate of 3.2 percent, and is placing pressures on land use in a predominately agriculture-based economy.

Per capita income in 1987 was \$174, which is below the average for sub-Saharan Africa. Agriculture is the major economic activity, accounting for over 35 percent of national product and providing a livelihood for about 90 percent of the population. Agriculture also accounts for about 88 percent of Malawi's export earnings, mainly from tobacco, tea, and sugar.

From Malawi's independence in 1964 until the late 1970s, the country was able to achieve a real per capita income growth of 3 percent per annum with relatively stable financial conditions by pursuing liberal free-market economic policies. Since that time, for a complex set of reasons, this growth rate has slowed; inflationary pressures have increased; and the balance of payments position has deteriorated. The economy recovered somewhat during 1982-1984, with real per capita income growing at 4 percent per annum, but since 1984, performance has weakened significantly, owing primarily to a sharp downturn in the terms of trade, connected with transport difficulties. In 1984, rail links to Beira and Nacala in Mozambique were closed because of Mozambique's civil war. Imports and exports must be shipped at high cost via a combination of road and rail links through Zambia, Zimbabwe, and South Africa to and from the port of Durban. This transportation crisis, combined with little growth in international prices for Malawi's major exports, has resulted in an average growth in per capita income of only 2 percent per annum since 1980.

During 1987, the government took a number of actions to address the deterioration in Malawi's domestic and international financial position. A program to mobilize revenues and contain expenditures was introduced in August 1987; maximum bank lending interest rates were deregulated (they rose by 4 percentage points to about 26 percent); and deposit interest rates increased by 3 percentage points (raising the 12-month rate to 17.25 percent) in July 1987. In February 1987, the local currency, the Malawi Kwacha, was devalued by 20 percent as compared to a reference index of other currencies used by the government. Other changes included the liberalization of smallholder agricultural marketing, continued adjustments in producer prices, and further actions to improve the performance of parastatals, particularly the Agricultural Development and Marketing Corporation. The government has also taken steps towards a tax reform program to increase revenues and broaden the tax base. Despite these positive changes, domestic economic performance continues to be a problem: inflation rose to 25 percent, and real output fell by 0.2 percent in 1987.

For a country of its size and level of economic development Malawi has a well developed financial system. The system is governed by a central bank, the Reserve Bank of Malawi, and includes two commercial banks, four development finance organizations, and several other specialized financial institutions that operate on a commercial basis.

Local moneylenders in Malawi provide small, short-term, unsecured loans. Informed sources in Malawi believe that these informal loans are usually for amounts less than \$40 and that they carry interest rates ranging from 50 to 100 percent per month. The informal credit system is also a source of funds for

workers emigrating to neighboring countries such as South Africa to find employment. These loans usually are for the period of a worker's expatriate employment, normally three years. It appears that the usual interest rate for these loans approaches 33 percent for the term of the loan, i.e. the borrower is expected to pay 100 percent interest on the amount borrowed upon his return to Malawi.

1.1 The Policy Environment

It is only recently that the government of Malawi has addressed the macro-policy issues that have the greatest impact on microenterprises. With the adoption of the State merit of Development Policies: 1987 - 1996, the government has committed itself to "support small-scale enterprise, formal and informal." To further this objective, the Ministry of Trade, Industry and Tourism has embarked upon an effort to strengthen its small industries unit to promote further growth in the small and medium-sized enterprise sector. The Ministry's mandate includes collaboration with other small enterprise intermediary institutions to help strengthen credit, technical assistance, and training services to small-scale entrepreneurs in Malawi.

The most recent significant development in the policy environment is the World Bank-sponsored Industrial Trade Policy Adjustment Credit. A.I.D. will co-finance this World Bank-sponsored program, which will focus on policy reform, tax regulation reforms, and liberalization of foreign currency regulations. A.I.D. will provide \$35 million under its Malawian Enterprise Development Program (MED) for (1) direct program assistance in support of policy and institutional reform, and (2) a project component to fund technical assistance and training in support of program objectives and the policy dialogue process.

These efforts, particularly as they relate to taxation, foreign exchange, and licensing regulations, have the potential for making a positive direct impact on microentrepreneurs in Malawi. Many such enterprises, however, operate outside the formal systems, and may not benefit by these structural and policy changes.

1.2 Characteristics of the Small Enterprise Sector in Malawi

Information about the enterprise sector in Malawi is limited. The government keeps statistics on licensed businesses, but at present there are only 156 registered small-scale industrial establishments (defined as those with 20 or fewer workers) which employ a total of 1,370 people. Using data based on a 1984 study of small-scale industry in Malawi by Ettema, the Rural Enterprise and Agribusiness Development Institutions (READI) project estimates that approximately 182,000 small enterprises are operating in Malawi.

In 1987, READI completed the first nationwide survey of small enterprises in Malawi, entitled "New Directions for Promoting Small and Medium Scale Enterprises in Malawi: Constraints and Prospects for Growth." The study was based on a sampling of 1,383 businesses. The analysts on the survey team also used official statistics as well as data gathered through earlier industrial sector studies.

More than 96 percent of entrepreneurs sampled were sole owners of their businesses. The majority of businesses fell into three categories: trading (42 percent), service (26 percent), and manufacturing (30 percent).

Further analysis of small enterprise investment data generated from the READI survey indicate that wholesale and retail trading accounted for the majority of money invested (34 percent), with restaurants, bars, and hotels ranking second (27 percent), other manufacturing ranking third (10 percent), and textiles and clothing, food processing, and services last.

Approximately 3,000 people were employed in the businesses surveyed, representing an average of 2.5 per enterprise. As could be expected, urban enterprises in the more economically active Southern Region had the highest average (4.6 employees), while rural businesses in the Northern Region had the lowest (1.1).

Gender-disaggregated data collected through the survey showed that women constituted only 19 percent of the total number employed in small enterprises surveyed. This suggests that job opportunities for women in small enterprises are limited. The only small enterprise activity in which female employment approached that of males was in the hotel, restaurant, and bar industry. In the agriculture sector, by comparison, a 1977 census carried out by Malawi's National Statistics Office showed that 94 percent of women of working age were engaged in subsistence farming, with only 2 percent self-employed; this compared with figures of 62 and 7 percent for men in the same categories.

More than half of the respondents in the survey stated that acquiring start-up capital was the biggest problem; about the same percentage cited the scarce or high cost of capital for purchasing additional equipment and materials as a significant constraint. This response is supported by the reported rate of interest for informal credit markets of 50 to 100 percent per month.

As far as capital was concerned, three-quarters of the enterprises in the READI survey were started with less than \$370. Ninety-one percent were begun with the entrepreneurs' own savings; only 16 percent had applied for loans during the previous two years. In interpreting this information, it is important to note that formal credit for small enterprises has only been available in Malawi since 1982, with the exception of a \$200,000 program in 1978/79 operated through the Investment and Development Bank. Other indications are also present that lack of access to credit at reasonable prices constrains microenterprise growth. Informal market money rates are reported to run from 50-100 percent a month as noted earlier, well out of proportion to the risks and costs of serving microentrepreneurs experienced by lenders such as the Malawian Union of Savings and Credit Cooperatives (MUSCCO).

Even today, commercial bank participation in financing small and microenterprises is very limited. The largest number of loans to small enterprises in Malawi are provided by two specialized small business development institutions. Even with the establishment of small enterprise development finance intermediaries, most of the capital formation in this sector has been financed through entrepreneurs' own savings or through dealings in informal credit markets.

2. DESCRIPTION OF A.I.D. PROJECT ACTIVITIES IN SUPPORT OF MICROENTERPRISE

A.I.D. has provided funds for institutions to assist microenterprises for several years. Since 1980, A.I.D. has provided financial resources for microenterprise technical assistance, credit, and training primarily through the Development of Malawi Traders Trust (DEMATT) and MUSCCO. This support has come through various contractual and funding mechanisms. A.I.D. first provided support for DEMATT through a grant to Partnership for Productivity International (PfP/I) in 1980. In the same year, A.I.D. awarded a grant to the World Council of Credit Unions/Credit Union National Association (WOCCU/CUNA) to provide technical assistance to the recently formed MUSCCO. In 1984, A.I.D. began funneling its financial support for MUSCCO through the READI project. READI provided \$300,000 in credit funds, to be lent by MUSCCO to the country's 79 local savings and credit co-operatives and funds to support continuing technical assistance from WOCCU/CUNA. Following the demise of PfP/I at the end of 1986, the READI project also became the mechanism to continue financial support for DEMATT.

A.I.D., however, is now beginning to shift from this supply side support of particular service institutions to a broader program strategy aimed at policy reform to assist enterprise development in a more general context.

Other A.I.D. initiatives serving the microenterprise sector include the Human Resources and Institutional Development (HRID) project, the Support for Health, Agriculture and Rural Enterprises (SHARE) project, and the MED Sector Assistance program. HRID aims to improve technical and professional capabilities within several organizations working in enterprise development, including MUSCCO and DEMATT.

SHARE, which is at a preliminary stage of development, will serve as an umbrella for funding the efforts of private voluntary organizations (PVOs) working in the small enterprise sector.

MED has two components which embody A.I.D.'s efforts to shift from a project approach to a program strategy aimed at policy reform for enterprise development. One component is direct financial assistance in support of policy and institutional reform. This is an amount of foreign exchange put at the government's disposal depending on its meeting various conditions. The other component includes technical assistance, studies, and training in support of the policy dialogue process in Malawi. MED's program assistance component provides \$35 million for stimulating policy reforms aimed at liberalizing foreign exchange allocations for spare parts and raw materials; the program is designed to parallel reforms embodied in the World Bank Industrial Trade Policy Adjustment Credit. MED conditionality in its second and third years of implementation is directed toward removing obstacles to the expansion of small and medium enterprises and to increasing the labor absorptive capacity of the economy.

In addition to A.I.D.'s initiatives, several other donors are actively providing support to Malawi's micro and small enterprise sector. Donor coordination of small enterprise development is managed by the World Bank through a Donor Coordination Sub-Group on Small-Scale Enterprises. Participants include representatives from the European Community, Germany, the Netherlands, United Nations agencies, the World Bank, and A.I.D.

A review of the minutes of a recent meeting of this group (April/May 1988) shows that the issues discussed ranged from government policy to the impact of various intermediary institutions on the small enterprise sector in Malawi. As could be expected, there is no consensus among members regarding all aspects of small enterprise development strategies and methodologies; however, these meetings provide a useful forum for donors to discuss and coordinate their small enterprise development programs.

Among the important institutions primarily funded by other donors is the Small Enterprise Development Organization of Malawi (SEDOM), which provides loans to Malawian entrepreneurs to enable them to set up, acquire, expand or improve industrial ventures. This effort is jointly being financed by the European Economic Community and by the Government of Malawi. SEDOM runs several different loan programs. Its mini-loan program provides up to \$1,200 at 18 percent annual interest for a two year term. But SEDOM also makes loans, at the same 18 percent interest rate for as long as 12 years -- and can loan up to \$29,000. It also does lease financing.

Another important institution is the Malawian Entrepreneurial Development Institute (MEDI), a United Nations Development Programme (UNDP) funded training program for small businessmen, which also operates a loan program for its graduates. These loans are largely in kind, at an annual 15 percent rate, and for a five year term.

MEDI has received A.I.D. funds for some of its programs. Both MEDI and SEDOM have been closely integrated with the activities of the READI project.

3. FINDINGS AND ANALYSIS

The two institutions reviewed are MUSCCO and DEMATT. Both organizations work with microenterprises: DEMATT provides business and technical advisory services; and MUSCCO is a credit union movement dedicated to stimulating savings and facilitating group-based lending. Although most of MUSCCO's members are engaged in agriculture, some of their members borrow to support the small shops or the cottage industries that they operate.

Both projects are funded by A.I.D. through its umbrella project, READI. The goal of READI is to enhance the capability of certain institutions -- governmental as well as private -- to provide the necessary services for promoting private enterprises in Malawi. These services include credit, training, and business advisory technical assistance. Other institutions supported by READI were not selected because they do not work with microenterprises as defined by this stock-taking exercise. Our discussion of impact will address the overall role of READI since it has made a positive contribution to improving the policy environment for enterprise development in Malawi including that of microenterprises.

A major focus of the READI project has been to try to have a positive impact on the policy environment in which private sector and microenterprise promotion takes place. This has been done by sponsoring relevant research, serving as an adviser to the relevant government units, and by supporting pilot projects like DEMATT and MUSCCO. As a result of increasing government interest in small enterprise development, READI, in 1986, undertook the first national survey of small-scale enterprises in Malawi, the data from which was used to help clarify the current status and future potential of this sector in the country's overall economic development.

3.1 Development of Malawi Traders Trust

DEMATT was created in 1979 with a mandate "to offer advice, promote new business ideas, develop entrepreneurs, and facilitate access to credit." DEMATT first received A.I.D. support in 1980

through a grant to PfP/I. In March 1987, following the demise of PfP/I, A.I.D. incorporated its assistance to DEMATT under the READI Project, and assigned a technical assistance role to Africare, a U.S.-based PVO.

DEMATT offers business advisory and technical advisory services to micro and small-scale entrepreneurs. Prior to its participation in the READI project, DEMATT used a group training approach developed by Malcolm Harper in Kenya in the mid-1970s. According to the staff of DEMATT, this approach was not demand-driven, and had very little impact. The focus was more on training a great number of entrepreneurs than on the quality and appropriateness of the training itself.

Since that time, the approach has been refined and although DEMATT still conducts group training, courses are designed based on an individual analysis of entrepreneur needs and problems. DEMATT employs a two-stepped client service methodology in which the DEMATT field officer and the client work together to identify specific needs or problem areas such as bookkeeping, production management, or marketing. Then, after identifying 10 to 15 clients with the same needs, DEMATT will arrange a group training program to address those needs. This methodology has the advantage of cutting the costs of delivering technical assistance and training. Although its post-READI approach is new and as yet unevaluated, it promises to be a significant improvement over past practices.

Follow-up to group training is an essential component of DEMATT's program. All follow-up is one-on-one, and is done with DEMATT's other ongoing client service activities; this works because all trainees are DEMATT clients selected by DEMATT field officers. The DEMATT field officers have a knowledge of the client gained through close contact. This knowledge helps to focus the training assistance. It is incumbent upon field officers not only to select trainees, but also to ensure follow-up. Because client training is tied directly to solving a client's problems, the field officer gauges how effective the training has been by the extent to which the client's problems are addressed. This emphasizes the integrated, needs-driven approach of DEMATT training and fits in very well with DEMATT's overall approach to field services. That is, client training is not viewed as an end in itself; it is viewed as a means to address a client's needs by removing particular obstacles.

In the 1986-1987 period, DEMATT provided business advisory and technical advisory services to 545 enterprises with a total of 1,254 employees. DEMATT classifies its clients into three types of enterprises: traders, producers, and service businesses. Based on sample survey data gathered in 1988, 37 percent of their clients are classified as traders, 54 percent as producers, and 9 percent as service enterprises. The average number of employees per enterprise (including owners/managers) is two for traders, 3.5 for producers and four for services. Five percent of DEMATT's clients were females engaged primarily in trading activities.

Financial self-sufficiency was an important objective for DEMATT in its early phases. One of PfP's major efforts was to diversify operations into revenue-generating activities including such things as gemstone mining. These efforts were not successful. The consensus among present DEMATT staff is that these schemes diverted scarce management time and resources from the organization's primary responsibility of providing technical and management assistance to micro and small-scale enterprises.

At no time have any fees been charged nor does the DEMATT management feel that this is feasible. DEMATT has thus not sought to support its operations from its earnings but the organization intends to remain totally dependent on government grants. On the other hand, DEMATT has moved to strengthen its organization, and thus presumably control its costs.

Many of DEMATT's staff felt that the shift to READI was positive for DEMATT's institutional development. Since A.I.D. assistance to DEMATT has been incorporated under the READI project, the project focus has shifted to improving the organization and management of DEMATT, and enhancing its capacity to serve microenterprises, rather than simply providing a large volume of training services of uncertain quality. The project might be described as being in a transition period. DEMATT has produced less impact than they might have under more stable and effective management.

The DEMATT provides only technical assistance and training. In these circumstances, reaching financial self-sustainability through side ventures or the imposition of client fees is unrealistic. Side ventures, as demonstrated by DEMATT's efforts in mining, draw attention away from the organization's primary objective of serving its clients and often lead to losses. Fees for services, although they may be useful for ensuring client commitment, cannot generate enough revenues to offset costs, given client size and capacity to pay. This should not deter DEMATT from adopting a scale of fees based on the demand for services among their clients and their ability to pay.

If the DEMATT is not intended to be financially self-sustaining, the clients are clearly intended to benefit from its services. DEMATT, however, appeared to be so involved with its own organizational problems that it was limited in what it could do for its clients. Data on the impact of services to clients were lacking.

DEMATT has recently adopted a monitoring system which will yield useful information on client progress. But collection of any data is difficult because of clients' unwillingness to cooperate by supplying data.

Based on a sample survey of DEMATT clients, the average monthly sales for traders is \$1,650, for producers \$360, and for services \$650. We do not know the profitability of these various businesses because balance sheets and profit and loss statements were not available. Some entrepreneurs move on very quickly from DEMATT, within a year or two, whereas in other cases, some businesses ~ have been DEMATT clients for as long as eight years. It is even difficult to measure how satisfied DEMATT's clients are with its services.

In 1986/87 DEMATT reached 545 of a potential market of 182,000; the obvious conclusion is that it has a relatively limited impact on the country's overall economy.

3.2 Malawian Union of Savings and Credit Cooperatives

MUSCCO is the apex body for the country's savings and credit cooperative societies. These cooperatives are in the words of MUSCCO's 1986 Annual Report: "the only financial institutions in the rural areas that provide both a place to save and a place to borrow."

MUSCCO began operations in 1980 with the objective of developing a sound and viable Credit Union movement throughout Malawi by improving the management skills and credit worthiness of credit societies and their members. MUSCCO field staff work to identify, develop, and eventually graduate groups of homogeneous savings and lending societies to financial self-sufficiency. Once a certain level of savings has been achieved, MUSCCO lends money to the credit society up to a limit defined as a proportion of its accumulated savings and the societies then re-lend this money to their members. Because

the amounts are tied to savings levels, loans are relatively small in the initial years, and grow gradually as the society matures and its capital base becomes larger.

Under these lending programs MUSCCO provides supplemental funds to its member societies for re-lending. In mid- 1988 it was lending funds to those societies at 1-12 percent for short term relending. The societies in turn lent to their members at 18 percent per annum.

The individual member is permitted to borrow up to some limit set as a proportion of the savings accumulated. A select handful of society members have been able to move from the short-term financing offered directly through the local societies to a long-term credit program funded by MUSCCO. Under this program funds are lent to certain selected societies at 11 percent per annum, and relent to the qualifying members at 16 percent per annum. It is this long-term credit program that is the focus of A.I.D.'s current support to MUSCCO. Under the long-term program, which will extend loans up to five months, MUSCCO has approved loans totaling almost \$37,000 to 25 small enterprises. The average loan under this program is \$1,462. Since this is a relatively new program--the first loan was made in April 1 1986--it is too early to determine whether or not borrowers will be able to graduate from this program to the commercial banking system, as is intended.

In the two and a half years from December 31, 1985 to June 30, 1988, the number of societies has risen from 50 to 77, even though membership declined slightly. Savings have risen, nonetheless, 42 percent in nominal terms, and per member savings by 50 percent. Some membership attrition can be attributed to the fact that societies maintain fairly rigorous standards of savings and group participation.

Lending levels are somewhat higher than savings levels. Loans are 10 percent of savings. Though this is a violation of purist credit union principles, it is in accord with the government's desire to direct increased credit to the society members.

There is not enough data to determine how financially self-sufficient the member societies are. Generally speaking, the cost of operating a local- credit society is low. Except for one or two paid bookkeepers, management expenses are negligible; for example, members of the board of directors which is responsible for setting policy and overseeing operations are not paid. It is thus possible for societies to be financially self-sustaining in terms of covering their operating costs from interest income, if their arrearages are controlled.

At the national level, MUSCCO has made significant strides to become more financially self-sufficient. But it still depends on outside subsidy, for example in the form of foreign volunteers, and earnings on significant idle bank balances it holds, as well as the technical assistance support it has gotten from A.I.D. since 1980. Its interest income is overstated in real terms as well, since it is, as is proper for a financial institution on an accruals rather than cash basis, and thus includes income due but not received. Revenue from all sources including the interest on loans to local societies, bank deposits, and other sources, covered over 23.5 percent of MUSCCO's operating costs in 1987. This is more than double the percentage registered in 1985. In all likelihood, MUSCCO will require substantial assistance for the foreseeable future.

The most significant impact of MUSCCO has been to provide a savings and credit mechanism to rural poor in Malawi where none existed before. In many of the 79 villages that have credit societies, there are no other financial institutions or sources of credit other than the informal credit markets.

There is no data available to measure the income or employment impact of the loans to society members made by MUSCCO. Even data which distinguishes the purposes for which society members borrow was not available to the team. Some of the borrowing finances household consumption, including school fees and funeral expenses. In addition, some of the borrowing finances productive investment including the purchase of fertilizer and other agricultural inputs according to informed observers. Nor were gender-disaggregated data available on borrowers.

The savings and credit union movement in Malawi has been able to mobilize savings of \$520,000 and has a current portfolio of loans of almost \$575,000. These have presumably resulted in some increase in economic activity and efficiency. The increase, however, is not without cost. In addition to the continuing need to subsidize MUSCCO itself, extensive expatriate technical assistance to MUSCCO has been required. A.I.D. has provided over \$1.5 million in technical assistance through World Conference of Credit Unions/Credit Union of North America to MUSCCO since 1980.

4. FACTORS INFLUENCING PROJECT PERFORMANCE AND IMPACT

The following factors influence the performance and impact of the DEMATT and MUSCCO projects.

- (1) The projects lack management information systems and the administrative capacity to monitor their performance and measure their impact on beneficiaries. Little data on project activities and clients are available, and the projects appear to be operating with little knowledge and regard of their impact. Without knowing the true extent and nature of their clients, the projects cannot possibly develop ways of improving their organizational efficiency.
- (2) The long-term sustainability of these organizations is endangered by high administrative costs due to inefficiency; and an unwillingness to charge interest rates, or service fees high enough cover a significant portion of their operating costs. DEMATT does not charge for its services, and MUSCCO charges below market interest rates. These subsidized activities reduce the possibility of sustainability and assume continued indefinite grant support. The projects lack a market test of the value of their services, and are unaware to what extent clients perceive value in their services .
- (3) The rigidity of formal sector financial markets means that DEMATT, MUSCCO, and other programs like them are the only ones providing credit and technical assistance to small enterprises in Malawi, and that graduating their clients to the formal sector is nearly impossible. To the extent that microenterprises are dependent on credit and technical assistance, it will be organizations like DEMATT and MUSCCO which will be required to deliver them. Even after receiving the assistance of DEMATT and MUSCCO the clients are not yet to the point of being accepted by existing formal sector institutions.
- (4) MUSCCO and individual credit union sustainability is adversely affected by the high level of arrearages. As of June 1988, these ran to 25 percent in the northern and central regions, and 7.3 percent in the southern, more developed part of the country. Financial institution cannot be sustained for long with such high levels of arrearages, and is a further indication of administrative and management problems.

5. LESSONS LEARNED, IMPLICATIONS FOR FUTURE PROGRAMS
AND POLICY DIRECTIONS

- (1) Credit unions are an effective way to develop a financial intermediary which provides saving and loan facilities to small clients. While credit unions have the means of reaching these small savers they can do so only when they are effectively managed. To the extent that these small clients are microentrepreneurs, credit unions can provide working capital loans, to increase inventory or adjust to seasonal levels of business activity. Evidence is inconclusive to determine if credit unions can play a significant role in the development of new microenterprises.
- (2) It is costly and requires a significant period of time to develop national credit union networks with a relatively high degree of management sophistication. The costs correspond to building organizational capacity in the governing body and the individual credit unions. The training and development of the members can be achieved by the credit unions that have benefited from the institution building assistance. MUSCCO is a good model for what might be called "pre-entrepreneurial development." A credit union can train its clients in the use of credit, and thus leverage the assistance provided through the institution-building project.
- (3) Successful small-scale lending projects require a foundation of management skill development and ownership of capital resources, for providing credit to the rural informal sector markets. Savings mobilization from small savers quickly defines the appropriate level of operation and lending for a small-scale lending project. It is also a cost effective means of meeting at least some portion of capital requirements.

It may therefore be inappropriate to direct an organization like MUSCCO into serving a larger size class of clients before it is ready. Lending levels of 10 percent of the savings base is an indication that there is an excess of external funds available to the credit unions.

- (4) Technical assistance-focused models like DEMATT's can charge at least nominal fees to clients to help cover costs and test the market value of services provided. Technical assistance projects are high cost in terms of providing the service, and supporting the delivery organization. Without charging service fees, clients have to invest relatively little if anything to get this assistance. If the full cost of the technical assistance cannot be borne by the client, any payment made would help reduce the reliance on outside grant funding.

The low skill levels and poor organizational structures existing in developing countries combined with the high cost of expatriate technical assistance to address them means that costs will be high and can only be reduced slowly. But this means that it is important to control these costs, and try to cover as much of them as possible from user fees.

- (5) Microenterprise development projects need to establish baseline data from the start of the project assistance, and collect impact data on beneficiaries as the project is being

implemented. Ideally this data can be compared with a control group that has not received the projects services. This is essential to accurately measure project performance. With this data changes in the enterprises since the introduction of technical assistance or training can be measured, and at least partly attributed to the intervention.

- (6) Projects supplying credit and technical assistance to microenterprises should develop a contractual mechanism with clients specifying the terms of participation, and offering mutually recognizable terms for termination of the contract. This is only sound business-like management. It also provides a means of gaining access to client records. DEMATT had difficulty collecting data from clients because they were reluctant to "open their books" for fear of being audited for tax purposes. Under a contractual agreement, the client may have a better understanding of the intervention.
- (7) The graduation to the formal sector of clients of promotional institutions such as DEMATT and MUSCCO is so unlikely it should not be a matter of practical concern. Institutions are not in place to serve even the larger clients of these organizations, even if numbers of clients were weaned away from subsidized services. For the foreseeable future, institutions like these are the only feasible type of formal sector channels for providing credit and technical assistance. The challenge is to move them toward greater self-sufficiency and concern with impact.

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